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10/5/88

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

A Two-Part Report: A and B

NO. 37B
September 30, 1988

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Japan's Economy Appears To Stumble In Second Quarter

At first the news seemed too good to be true. In 1988's first quarter Japan's price-adjusted gross national product reportedly streaked ahead at an 11.2 percent annualized clip. The bad news that followed three months later was equally lacking in credibility. In the just released data for the period from April through June, real GNP appeared to contract 3.9 percent (see Table).

What happened? Neither set of figures is as outlandish as it appears. One of the culprits is the calendar. With an extra day for leap year in the first quarter and fewer working days than normal in the second because of a

Japan's Real Gross National Product at Constant (1980) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1986	FY 1987	July-September 1987	October-December 1987	January-March 1988	April-June 1988
Gross National Product	Y301,679.7 (2.6%)	Y316,588.6 (4.9%)	Y313,030.0 (8.4%)	Y318,776.3 (7.5%)	Y327,320.1 (11.2%)	Y324,086.8 (-3.9%)
Personal Consumption Spending	169,195.1 (3.6%)	175,903.9 (4.0%)	174,877.5 (4.2%)	175,663.0 (1.8%)	180,134.2 (10.8%)	181,223.6 (2.1%)
Private Residential Construction	15,637.9 (10.9%)	19,368.0 (23.9%)	18,679.1 (47.5%)	21,042.6 (61.1%)	21,250.9 (4.0%)	19,254.2 (-32.6%)
Private Fixed Nonresidential Investment	56,361.2 (4.5%)	62,107.9 (10.2%)	60,554.5 (11.2%)	63,065.7 (17.6%)	65,450.6 (16.0%)	68,430.4 (19.7%)
Change in Business Inventories	515.2 (*)	974.1 (*)	716.3 (*)	1,172.2 (*)	1,082.7 (*)	1,722.4 (*)
Government Current Expenditures	29,002.0 (6.8%)	28,779.3 (-0.8%)	28,648.5 (-1.1%)	28,706.9 (0.8%)	29,028.8 (4.6%)	29,133.8 (1.5%)
Government Fixed Investment	22,162.2 (6.6%)	24,558.9 (10.8%)	23,496.0 (12.8%)	25,046.4 (29.1%)	26,045.3 (16.9%)	25,265.6 (-11.1)
Change in Government Inventories	816.0 (*)	41.5 (*)	-9.2 (*)	-163.3 (*)	452.3 (*)	60.1 (*)
Net External Sector	7,990.1 (-35.0%)	4,855.0 (-39.2%)	6,067.3 (52.0%)	4,242.8 (-76.1%)	3,875.3 (-30.5%)	-1,003.3 (-99.6%)
Exports of Goods and Services and Factor Income Received	52,689.5 (-3.6%)	55,372.7 (5.1%)	55,981.6 (29.6%)	55,472.2 (-3.6%)	57,714.7 (17.2%)	55,499.3 (-14.5%)
Imports of Goods and Services and Factor Income Paid	44,699.5 (5.5%)	50,517.7 (13.0%)	49,914.3 (27.2%)	51,229.4 (11.0%)	53,839.4 (22.0%)	56,502.6 (21.3%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

longer-than-usual holiday season, the GNP figure was distorted upward in the January-March period and downward in the April-June quarter. The effect was to overstate the rate of growth in the first quarter and to understate it in the second, although probably not by enough to remove the difference in the growth rates entirely. Certainly on a year-to-year basis the economy still looks strong, with the second quarter 5.3 percent ahead of a year earlier.

The pattern of growth in the April-June period, if not its rate, showed a familiar pattern. For the third straight quarter, net external demand was a drag on overall growth, but the effect was far larger than previously. Imports adjusted for price changes soared 21.3 percent from the January-April level, while the volume of exports plummeted 14.5 percent. The result was that net exports shaved 1.5 percentage points off the overall quarterly growth rate, resulting in a rate of -1 percent.

This left domestic demand with a 0.5 point contribution to the quarterly growth rate. In fact, though, total government spending declined, knocking 0.3 point off overall growth. That made private domestic spending the one bright spot, with an 0.8 point contribution. The figures, in other words, underscored the economy's underlying strength; the economy was strongest where it most needed to be. Barring further bumps in the data, this suggests future quarterly figures could show gains without continuous doses of government stimulus or boosts in exports.

Within the private sector, corporate investment rather than housing was the principal engine of growth, a pattern apparent in the previous quarter. Housing declined at an annualized 32.6 percent rate, while private plant and equipment investment was up 19.7 percent. Consumer spending, which by itself accounts for about 56 percent of the whole economy, increased a scant 2.1 percent, although it may have been affected more by the ravages of the calendar than most other figures.

The figures just released are the first installment of GNP data for FY 1988. While the negative growth in the April-June period would appear to make the government's outlook for 3.8 percent real growth in FY 1988 harder to reach, private forecasters so far have not altered their own forecasts, which generally have been more optimistic than the government's. Even after seeing the latest GNP figures, many analysts are still projecting fiscal year growth in excess of 5 percent.

Their optimism is based in part on more recent data than the GNP figures. For example, seasonally adjusted electric power usage, after stagnating in the April-June period, rose again in both July and August. Some analysts are already forecasting a return to positive GNP growth in the July-September quarter. And some indicators of future activity are at record levels. For example, the Bank of Japan's index of business sentiment (those responding that conditions will be favorable less those saying unfavorable) is a positive 42 for December, one of the highest readings in recent memory.

The recently enacted tax cut, with an estimated impact in FY 1988 of Y1.27 trillion ($10.2 billion at $1.00=Y125), will give the economy a small additional boost (see JEI Report No. 30B, August 5, 1988). By contrast, the April-June GNP figures reflect a trailing off of the effects of the 1987 fiscal stimulus package of spending increases and tax cuts.

Generally, the watchword for the immediate future is stable growth. The Economic Planning Agency minimized the significance of the latest GNP figures and suggested that growth will continue. In this view, the latest data are a shot across the bow -- not about impending weakness in the economy but about reading too much into a single set of numbers.

Douglas Ostrom

Manufactured Imports Increasing

One of the persistent complaints about Japan's trade structure has been that the country's imports of manufactured goods are far too low. As a country poor in natural resources, the argument goes, Japan naturally has to import raw materials, but as a wealthy country with a large trade surplus that can afford a little luxury, it should import more manufactured goods to complement its own formidable production. The result would be lower prices and better variety for Japanese consumers, cheaper inputs for some manufacturers and reduced trade frictions.

Over time Japan's imports of manufactured goods have shown a tendency to rise as a percentage of total imports, although the level is still lower than that of other industrialized countries (see JEI Report No. 14A, April 8, 1988). Recent data confirm the long-term trend. During the first half of 1988, manufactured goods imports soared 49.4 percent in dollar terms and 36.8 percent in volume. For this period manufactures represented 48.1 percent of all imports, up from 43.2 percent in the first six months of 1987.

A disproportionate share of the increase in manufactured imports came from the overseas subsidiaries of Japanese firms, especially those located in Asia's newly industrializing economies. This trend is likely to continue. In a survey by the Economic Planning Agency, 37.3 percent of responding manufacturing firms with offshore production facilities said that they plan to initiate or increase imports into Japan from their overseas plants. Of course, they did not specify how much they would sell in Japan. Moreover, 58.9 percent of the companies indicated they have no plans to source products from their facilities abroad.

As the yen has appreciated, imports have become cheaper for Japanese customers. As a result, the manufactured import penetration of the Japanese economy has actually declined by some measures, at least until recently, even as the real rate of import growth has exceeded that of the economy as a whole. Between 1985 and 1987, the Bank for International Settlements estimates, imports of finished manufactured goods as a percentage of value-added in Japanese manufacturing declined from 10.2 percent to 9.6 percent. According to the Ministry of Finance, price-adjusted imports of manufactured goods increased 37.9 percent during this period.

Despite their still modest level, manufactured imports may be complicating the way the Japanese economy operates. A Sanwa Bank, Ltd. report suggests that rising product imports have altered the nature of adjustment to changing demand in the steel industry and elsewhere. In the past, falling steel inventory levels -- a result of surging demand -- would lead to a combination of